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PP RUEHDE RUEHDIR  
DE RUEHRH #1488/01 2801222  
ZNY CCCCC ZZH  
P 061222Z OCT 08  
FM AMEMBASSY RIYADH  
TO RUEHC/SECSTATE WASHDC PRIORITY 9279  
INFO RUEHZM/GULF COOPERATION COUNCIL COLLECTIVE PRIORITY  
RUEHJI/AMCONSUL JEDDAH PRIORITY 9779  
RUCPDO/DEPT OF COMMERCE WASHDC PRIORITY  
RUEATRS/DEPT OF TREASURY WASHDC PRIORITY

C O N F I D E N T I A L SECTION 01 OF 02 RIYADH 001488

SIPDIS

DEPT FOR EEB, NEA/ARP

E.O. 12958: DECL: 10/06/2013  
TAGS: [ECON](#) [EAGR](#) [EINV](#) [PGOV](#) [PREL](#) [SA](#)  
SUBJECT: INFLATION HIGH BUT NO THREAT TO SAG

REF: RIYADH 1258

Classified By: Deputy Chief of Mission David Rundell for reasons 1.4 (b)  
) and (d)

¶1. (C) Summary: Inflation in Saudi Arabia continued to climb in July and August but is expected to slow in the coming months. Key contributors to this increase are high economic growth, a limited supply of real estate, and global increases in food prices. While the Saudi Arabian Government (SAG) has been quick to announce steps it will take to ameliorate the effects of inflation, it has been slow to act. Nevertheless, the SAG's full coffers will allow them to take sufficient action to limit any political repercussions of inflation growth. End summary.

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Inflation continues to soar  
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¶2. (SBU) Inflation in Saudi Arabia continues to climb, passing 11 percent in July for the first time since 1978. Dr. John Sfakianakis, chief economist for Saudi Arabia British Bank, told Econoff he expected this to level off in the coming months but to remain relatively high for the next three to four years. According to Sfakianakis, the SAG can do little to limit price increases as they have few monetary policy tools available to them, and the booming economy coupled with dysfunctional markets that cannot meet demand for food, housing, and other needs will continue to place upward pressure on prices.

¶3. (C) Deputy Governor Dr. Abdulrahman al-Hamidy of the Saudi Arabian Monetary Agency (SAMA) generally concurred with this assessment, telling Econoff inflation in the Kingdom did not start accelerating until the economy "reached its limit" in mid-2006. He said rents would remain high for at least four years as the housing market plays catch up with much-needed new construction but food prices would moderate in the coming months as they fall internationally (the Kingdom imports almost all of its food).

¶4. (C) According to a September 4 article in Arab News, Saudi Arabia has a current shortage of 1,000,000 homes. It went on to state that in the year leading up to July, land prices in Riyadh doubled and that many of the new houses currently under construction would be too expensive for most of the population. Al-Hamidy elaborated on this problem, saying that high commercial and government demand for construction materials was driving up the cost of new housing even further.

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SAG slow to respond  
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¶5. (C) The SAG has been slow to respond to increasing

inflation, possibly not fully appreciating its severity until recently. Deputy Minister of Economic Affairs in the Ministry of Finance, Dr. Hamid al-Baz'y, told Econoff in a recent courtesy call that inflation in July and August "was more than expected." The SAG's primary response has been to increase social assistance available to Saudis and to institute a subsidy on rice, the main staple foodstuff in Saudi Arabia (see reftel). However, as of early September, this subsidy had not yet gone into effect. When asked about delays in its implementation, al-Baz'y stated there was no problem with the financing of the subsidy, merely a slight delay while the ministries of finance and commerce worked out how it should be put in place.

¶6. (C) Inflation is also limiting the SAG's ability to make economic reforms. According to British Economic Counselor Richard Wood, certain elements within the SAG would prefer to increase domestic fuel prices to levels that more accurately correspond to market levels, but these efforts are hamstrung by recent price increases in other sectors which make unacceptable the political cost of more expensive fuel.

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Threat to stability overstated  
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¶7. (C) Sfakianakis told Econoff that though food and rent are significant contributors to the rise in inflation, wages and service sector costs are also increasing. He went on to say that the publicly announced figure of 11 percent inflation actually understates the problem as the index used to compute this percentage does not accurately reflect consumer spending

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patterns. Nevertheless, he said that inflation does not present a serious threat to the SAG as the government has both the resources and the desire to placate Saudi nationals; and expatriates have no real political power or influence. This tracks with the lack of concern we observed on the part of al-Baz'y and al-Hamidy when discussing delays in implementing the rice subsidy or the potential inability of monetary policy to impact rising costs.

¶8. (C) Comment: Despite indications that inflation growth in the Kingdom is slowing, it is unlikely to fall substantially in the near future. Factors contributing to recent price increases are institutional rather than transitory, and as such will take time for the SAG to address. That said, price increases present no serious threat to SAG stability. On the contrary, they are a reflection of the economic success experienced over the past few years. So long as this success continues, and the SAG continues to address key economic concerns of the Saudi populace, political stability will not be undercut by economic factors. End comment.

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